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C O N F I D E N T I A L SAN SALVADOR 000905

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E.O. 12958: DECL: 07/29/2018
TAGS: ECON EPET ENRG EINV ES
SUBJECT: ENERGY CRISIS AVERTED - FOR NOW

Classified By: Charge d'Affaires Robert I. Blau, Reason 1.4 (b),(d)

¶1. (C) Summary. Electricity generators and distributors met with Econoffs July 29 to warn of possible brownouts and blackouts within two weeks. They feared ripple effects if the GOES called in US-owned electricity distributor AES,s bond that day to cover subsidy payments that the company is financing for the GOES. AES would not obtain another bond and the GOES would be forced to cut AES off from the electric grid. AES distributes 80% of the electric power in El Salvador. The other distributor, Delsur, was facing a similar fate in the next several weeks. The Charge on July 29 raised the U.S. companies' concerns with President Saca's Chief of Staff Eduardo Ayala Grimaldi. Ayala was aware of the grave situation and said the GOES would resolve the issue within the week and take steps to limit the amount of subsidies the companies will finance in the future. If the GOES follows through on its commitment the immediate crisis may be averted, but the underlying problem will not be resolved until the GOES reforms its unsustainable subsidy programs. End Summary.

Problem Mounting for Awhile

¶2. (U) Electricity rates in El Salvador have not risen since June 2006. In November 2006, President Saca announced that electric rates would remain frozen at least through the end of his term as President, June 2009. The electricity regulator, Superintendencia General de Electricidad y Telecomunicaciones (SIGET) has made sure that Saca's promise has been kept. However, the GOES and private companies have been paying for the subsidized electric rates. The state electric generator, Comision Ejecutiva del Rio Lempa (CEL) has been instructed to pay the subsidy but the private companies have been required to finance the subsidy for six month periods, until they get reimbursed by CEL.

¶3. (SBU) When fuel prices were lower, the financing burden was not too extreme. The companies would collect the set rate for the period and receive an adjustment payment six months later, based upon the actual price paid for the fuel. In 2003, AES carried approximately $2 million for six months. As fuel prices rose, the subsidy cost rose to $4 million per month in 2007 and to over $20 million a month in April-June ¶2008. In 2007, when fuel was below $100/barrel, CEL estimated the subsidy would cost the GOES $239 million through June 2009. The financial rating company Fitch more recently estimated the subsidy cost would run $400 million. Due to its concerns about the GOES ability to maintain the subsidy and GOES interference in the sector, Fitch reduced AES,s credit rating in June.

AES Reaches its Limit

¶4. (C) In early July, AES warned the GOES that it would be forced to forfeit its bond, which would jeopardize its future

power purchases if it did not receive a payment for the subsidy by July 21. After meeting with Chief of Staff Ayala, CEL, and SIGET, the parties agreed to postpone any action until July 28. On July 29, representatives from distributors AES, Delsur and electric generators Duke Energy and Nejapa Power met with Econoffs to discuss the urgent situation.

¶5. (C) AES Country Manager Fernando Pujals and the other participants agreed that unless something was done immediately brownouts and blackouts would occur by August 12, if not before. AES needed $17 million or it would forfeit its bond. Under Salvadoran law, the GOES would then demand that AES replenish the bond, which AES said it would be unable to do. The next step would be that SIGET would tell the electric grid manager Unidad de Transacciones (UT), to cut off AES from the electric grid. According to the companies, if the law was strictly followed, this would mean that AES, which distributes 80% of the electricity in the country, would be cut off by August 12. Delsur,s representatives said they would be in a similar financial situation in about three weeks.

¶6. (C) The electric generators, US-owned Duke Energy and Nejapa Power, said they would not be able to sell electricity if there was no guarantee they would get paid. In addition, they too have carried 50% of the subsidy financing for the GOES.

¶7. (C) The generators and distributors were concerned that the GOES would not act in time to avoid the serious consequences of bond forfeitures and electricity shutdowns. They asked for three things. First, they wanted an advance payment of the April-June subsidy that they would not receive until October under the current scheme. Second, they wanted the GOES to reduce the six month adjustment period down to one-to-three months. Third, they wanted the GOES to re-examine its subsidy policy. They acknowledged that President Saca,s July 22 announcement that he would eliminate the subsidy for non-residential users was a good first step. However, they noted that Saca said the subsidy would be eliminated in three phases over an unspecified period and it would not address the electric companies, immediate liquidity crisis.

Charge Raises Concerns to Saca,s Chief of Staff
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¶8. (C) Soon after Econoffs met with the electric companies (July 29), Charge was meeting with Ayala in Ayala's capacity as Chairman of the Board of the GOES's Millennium Challenge Account implementing agency, FOMILENIO. Charge used the occasion to raise the concerns of the electric companies and relayed the urgency of their financial situation. Ayala had just emerged from a meeting with President Saca, and said the GOES wanted to avoid any bond forfeitures and certainly did not want any electric outages. He said President Saca instructed CEL to take money out of its reserve fund to pay the electric companies, without being specific as to the amount. (Note: The electric companies told Econoffs July 29 that they doubted CEL had additional funds at its disposal. End note.) Ayala added that the GOES would reduce the period that the companies would have to carry the subsidy from six months to two months. The CEL financing would be done within a week, according to Ayala. In the interim, the GOES would make sure that AES would not have to forfeit its bond. The outlines of this deal are lead stories in July 30 media.

Comment

¶9. We think the GOES will try to deliver on its promise to resolve the immediate problem by paying the companies (though it may not be all at once) and reducing the time that the companies have to finance the subsidy. The GOES will also save itself $70 million by eliminating the subsidy for the non-residential electricity users. However, the resultant higher electricity prices for the industrial and commercial sectors (estimated to be as much as 38%) are likely to be

passed on, at least in part, to their clients, further fueling inflation, which stood at an annual rate of 9% for the first six months of the year. The electric companies' liquidity problems caused by GOES subsidies also raise questions about El Salvador,s investment climate, possibly delaying needed investment in new power generation projects.
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